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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products	)	Docket No. RM2017-3

INITIAL COMMENTS OF NETFLIX, INC.

(March 20, 2017)

Netflix, Inc. ("Netflix") respectfully submits these Initial Comments in response to Order No. 3673, Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products (Dec. 20, 2016) (Order No. 3673). Founded in 1997, Netflix is the world's leading subscription service for movies and TV shows. As of December 31, 2016, Netflix has 44.4 million international streaming memberships, 49.4 million domestic streaming memberships, and 4.1 million domestic DVD memberships, with overlap in the latter two categories. Netflix DVD subscription members order multiple DVDs, each of which is sent and returned by mail, making Netflix one of the largest users of First-Class Mail.

I. SUMMARY

These Comments focus on whether the market dominant cap system has achieved Objective 5 of 39 U.S.C. Section 3622(b)—"[t]o assure adequate revenues, including retained earnings, to maintain financial security." Some parties argue that the Postal Service's financial stability is in question because it needs money and has defaulted on payments to the Retiree Health Benefits Fund (RHBF). From this, they conclude that the cap system has failed to meet Objective 5. But Objective 5 cannot be interpreted to place the entire burden of the Service's financial stability on market dominant revenues alone. Instead, the Postal Accountability and Enhancement Act of 2006 (PAEA) established a comprehensive reform plan with many parts contributing to financial stability. We define the part Congress intended market dominant revenues to contribute and show that this contribution has been met. The cap system has thus achieved Objective 5.

We then address the defaulted RHBF payments. The Commission should not use Objective 5 to adopt a new rate system to recover the defaulted amounts from market dominant mailers. Section 803 of the PAEA codified the RHBF payment schedule and gave it the force of law. Only Congress, not the agency, can cancel the defaulted obligations. Moreover, a Commission-ordered rate increase to recover the defaulted amounts could hinder the passage of pending legislation that would benefit the Service's long-term stability.

A correct interpretation of the objectives in Section 3622((b) must be grounded in an understanding of the PAEA's plan, the reasons for its passage, and the past ten years of experience under it. We start by setting forth the relevant background of the PAEA.

II. BACKGROUND OF THE 2006 POSTAL ACCOUNTABILITY AND ENHANCEMENT ACT (PAEA)

A. The Postal Reorganization Act of 1970 and Growing Financial Concerns Leading to the 2006 PAEA.

The Postal Reorganization Act (PRA) of 1970 (Pub. L. 91-375, Aug. 12, 1970) changed the Post Office Department into the United States Postal Service (USPS), making it an independent agency in the executive branch, directed by a Board of Governors. Its monopoly status under the Private Express Statutes did not change, nor did the mailbox rule. As a check on any tendency to exploit monopoly power, the PRA provided that, in general, rates would be those recommended by a separate Postal Rate Commission. Importantly, the recommended rates were to be cost-based and to allow the Postal Service to break even. During the ensuing period, average rate increases aligned generally with the Consumer Price Index (CPI). For example, the First-Class Letter rate, CPI-U adjusted, was nearly constant from 1971 to January 2006.[1]

The PRA era, however, was not free of concerns and controversies. Many parties complained that the rate increases adopted, sometimes after several years, were too large and unpredictable, and that rate case litigation was convoluted and expensive. Although mail volumes grew throughout most of the period, there was increasing concern about electronic diversion and the possibility of a "death spiral," in which rate increases would cause volume

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[1] *See* Postal Rate Commission Press Briefing, Postal Rate and Fee Changes, Docket No. R2005-1, November 1, 2005, Graph 1. The Postal Service worked hard to keep rate increases at or below inflation. A USPS Press Release announcing rate increases for 1999 noted that the last rate change had been four years prior and that the proposed increase of only 2.9 percent was "the smallest in postal history" and "the second straight rate adjustment below inflation, effectively cutting the real cost of a First-Class stamp by several percent since 1995." USPS Press Release No. 67, June 30, 1998, at 1.

declines, which would lead to further rate increases and further volume declines.[2] In January 2001, GAO found:[3]

> Looking ahead, we have reported that the Postal Service faces an uncertain future as competition increases in the communications and delivery services sectors. The Service has reported that it faces significant threats from electronic substitution of mailed bills and payments and anticipates a financial squeeze resulting from declining First-Class Mail volumes that cover most postal overhead costs. Thus, a key oversight issue we identified for the Postal Service, Congress, and the American people was whether the Service might be headed for financial shortfalls that could, in the long run, hinder its ability to remain self-supporting while carrying out its mission of providing affordable, universal postal services that bind the nation together. The potential consequences if the Service incurs a series of large financial deficits could be increases in postal rates, declines in service quality, consolidation or closure of some facilities, or reconsideration of the scope of postal services as well as postal operations.

GAO subsequently placed the Postal Service on its list of "High Risk Areas" that warranted Congress's attention.[4]

Then two developments galvanized the industry to action. First, in 2002, the Office of Personnel Management (OPM) performed an analysis showing that the Postal Service had overfunded its CSRS pension obligation by $105 billion.[5] Second, GAO issued a series of reports calling for Congressional action to address the Service's "deteriorating financial outlook."[6]

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[2] *See, e.g.*, "The Strange Story of Postal Reform," Murray B. Comarow, National Academy of Public Administration, February 2007, at 6.

[3] "Major Management Challenges and Program Risks: U.S. Postal Service," GAO-01-262, January 2001, at 6.

[4] *See* USPS 2001 Comprehensive Statement on Postal Operations, at 4, 77; "High-Risk Series: An Update," GAO-05-207, January 2005, at 1, 5.

[5] *See* 2003 U.S. Postal Service Annual Report, at 20 (may be found at http://about.usps.com/who-we-are/financials/annual-reports/fy2003/html/contents.htm.)

[6] *See* "United States Postal Service: Information on Retirement Plans, GAO-02-170, December 31, 2001; "U.S Postal Service: Deteriorating Financial Outlook Increases Need for Transformation," GAO-02-355, February 28, 2002, at 9; "U.S. Postal Service: Moving Forward on Financial and Transformation Challenges," GAO-02-694T, May 13, 2002; "U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation," GAO-04-108T, November 5, 2003.

B. The 2003 Law to Address CSRS Overfunding.

On April 23, 2003, Congress passed Public Law 108-18, which accomplished three things relevant here: First, it allowed part of the CSRS overfunding to be used to pay down debt. Second, it required that another part be used to delay the next rate case. Third, it required the Postal Service to begin paying $3.1 billion per year into an escrow account. In order to fund the $3.1 billion, the Postal Service filed, and the Commission approved, an across-the-board 5.4 percent rate increase in Docket No. R2005-1.[7]

C. The PAEA's Comprehensive Postal Reform and the First Ten Years.

With billions held in escrow and additional billions potentially available through a recalculation of obligations for retirees with military service, the stage was set for comprehensive postal reform. On December 20, 2006, Congress passed Public Law 109-435, the Postal Accountability and Enhancement Act (PAEA). In it, Congress addressed the prefunding issues by transferring $17.1 billion from CSRS into a new Retiree Health Benefits Fund and making an adjustment for military service that lowered the Postal Service's CSRS payments by $1.6 billion per year. Congress also moved the $3.1 billion of escrow funds into the RHBF, and, in Section 803, required the Postal Service to make specific payments to the RHBF.[8] Section 803 set forth specific amounts for prefunding payments, from $5.4 to $5.8 billion, with annual due dates over a ten-year period.[9]

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7 Op. and Rec. Dec., Docket No. R2005-1, Nov. 1, 2005, Summary at i.

8 We refer to the payments for Retiree Health Benefits as "RHB payments." The RHB payments that were not paid as required by the PAEA are referred to as "defaulted RHB payments."

9 Section 803 of the PAEA, Pub. L. 109-435, Dec. 20, 2006, 120 STAT. 3251 and 3252, was subsequently codified at 5 U.S.C. Section 8909a. It is referred to herein as "Section 803." For the sake of simplicity, subsections added by Section 803, although technically subsections of 5 U.S.C. Section 8909a, are referred to as subsections of Section 803.

But prefunding was only one part of the PAEA. The Act amounted to comprehensive reform that affected almost all aspects of the Postal Service, as recognized by Congress and supported by stakeholders.[10] In addition to adjusting prefunding payments, the PAEA (a) divided postal products into market dominant (MD) and competitive (CP) categories, (b) placed a CPI price cap on market dominant products, (c) allowed the Postal Service to compete freely on competitive products, (d) gave the Postal Service considerable pricing flexibility for market dominant products, (e) allowed products meeting certain requirements to be moved from the market dominant category to the competitive category, and (f) allowed CPI rate increases to become effective each year with a compliance review at the end of the year. Other aspects of reform included instituting a new procedure for complaints, granting the Commission subpoena power, prescribing worksharing constraints, and changing the Service's governance structure.

On May 3, 2006, still under the PRA, and in line with its breakeven requirement, the Postal Service filed Docket No. R2006-1, with a test year of FY2008 and a 1 percent contingency factor. R2006-1 resulted in a rate increase of 7.6 percent (to be added to the previous 5.4 percent increase from R2005-1). The R2006-1 rate base thus became the starting point for annual CPI increases under the cap system.[11]

The new law began to take effect in 2007. The rate of inflation was mild, allowing a 2.9 percent rate increase in the first adjustment, which was implemented on May 12, 2008, Docket No. R2008-1. The rate of inflation slowed thereafter, making some rate adjustments small.

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[10] Senator Susan Collins described the broad support for the PAEA:

> We reviewed the recommendations of the President's commission and we heard from a wide range of experts and stakeholders, including representatives of the postal employees unions, the Postal Service itself, administration officials, mailers, the postmasters, postal supervisors, publishers—a wide variety of groups. In fact, there is a broad coalition supporting this bill, including many nonprofit mailers.

[11] We refer to the CPI price system that Section 3622 established as "the cap system."

Electronic diversion continued, but the exact pace of it was difficult to forecast. Beginning in 2008, the Great Recession began to have an effect. The Postal Service and the Commission viewed it as an exigent circumstance under Section 3622(d)(1)(E), and a temporary rate increase of 4.3 percent was implemented to cover its financial effects. That increase was removed on April 10, 2016. The volume of competitive products grew over the period, from 1.6 billion in 2008 to 4.5 billion in 2016.[12] The Postal Service borrowed during the period, up to its debt limit of $15 billion. Payments to the RHBF were $5.6 billion in 2008, a reduced $1.4 billion in 2009, and $5.5 billion in 2010. The Postal Service then defaulted on the 2011, 2012, 2013, 2014, 2015, and 2016 payments.[13]

Several bills that would have addressed the RHB payments were introduced into Congress, but only two became law.[14] Most recently, proposed bill H.R. 5714[15] was reported out of the House Committee on Oversight and Government Reform and scored by the Congressional Budget Office on November 11, 2016. H.R. 5714 included, *inter alia*, a one-time rate increase of 2.15%, the cancellation of the unpaid RHB amounts and the inclusion of them in a new amortization schedule, an actuarial change to use postal-specific data for calculating retirement benefits, and the transfer of eligible retirees' healthcare expenses from the RHBF to Medicare.[16] Not passed in the 114th Congress, the bill was reintroduced as H.R. 756 on

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12 *See* CRA Reports contained in USPS Library Reference 1 in Dockets No. ACR2008 and ACR2016. A small amount of this growth was caused by transferring market dominant products to the competitive category.

13 The Postal Service missed a total of $28.1 billion in payments. Postal Regulatory Commission Section 701 Report, November 14, 2016, at 6.

14 The two that became law were Pub. L. 111-68 in 2009 and Pub. L. 112-33 in 2011.

15 H.R. 5714—114th Cong: Postal Service Reform Act of 2016.

16 H.R. 5714 was expected to have the effect of reducing some of the Postal Service's prefunding obligations. *See* Congressional Budget Office Cost Estimate on H.R.5714, November 10, 2016, at 11, 14, and 16 (CBO Report).

January 31, 2017. H.R. 756 was ordered reported by the House Committee on March 16, 2017.[17]

In testimony before Congress, Commission Chairman Robert Taub noted that the Service had a small net income on an "*operational* basis" but was also experiencing liquidity problems. He explained that "[t]he accruing nonpayment into the statutory retiree health benefit fund and the long-term workers' compensation obligations have artificially skewed the Postal Service's current liabilities in relation to its assets."[18] This observation is consistent with the Postal Service's FY2017 Integrated Financial Plan, which shows controllable income of $0.1 billion but a net loss after projected RHB and other prefunding payments of $4.2 billion.[19]

On December 20, 2016, the Commission issued Order No. 3673, initiating the ten-year review prescribed by Section 3622(d)(3). In this docket, the Commission will determine whether the "system for regulating rates and classes for market-dominant products established under this section [3622] is achieving" the objectives in (b), taking into account the factors in (c). Of the 8 objectives and 13 factors listed in Subsections 3622(b) and (c), these Comments focus on one

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[17] H.R. 756--115th Congress: Postal Service Reform Act of 2017.

[18] Testimony of Robert G Taub before the U.S. House Oversight & Government Reform Committee, February 7, 2017, at 9, 13 (Taub Testimony).

[19] USPS Fiscal Year 2017 Integrated Financial Plan, filed with the Commission on December 2, 2016, at 3 (2017 IFP). The 2017 IFP may be found at https://about.usps.com/who-we-are/financials/integrated-financial-plans/fy2017.pdf.

key objective:[20] Objective 5 ("adequate revenues … to maintain financial stability").[21] To apply it correctly, we first review legal principles that constrain the Commission's interpretation of the objectives.

III. BASIC LEGAL PRINCIPLES APPLY TO THE COMMISSION'S INTERPRETATION OF THE OBJECTIVES.

There is no question that Congress expected the Commission to apply its expertise and discretion to determine whether the cap system is achieving the objectives, and, if necessary, how the system should be modified. However, the PAEA and general principles of statutory interpretation impose some basic legal restraints on the agency's exercise of discretion: Interpretation of the objectives must be consistent with statutory language and Congressional intent in the PAEA, and the Commission may not fabricate a new objective[22] or define an objective in a way that Congress did not intend. Basic legal principles include:

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[20] Our focus on Objective 5 in this discussion should not be interpreted as a concession that the other eight objectives are irrelevant. Most of these objectives have been achieved to a great extent by the cap system, and they should be weighed in favor of retaining the current system. They include: Objective 1 ("[t]o maximize incentives to reduce costs and increase efficiency"); Objective 2 ((([t]o create predictability and stability in rates"); Objective 4 ([t]o allow the Postal Service pricing flexibility"); Objective 6 ([t]o reduce the administrative burden and increase the transparency of the ratemaking process"); Objective 8 ([t]o establish a just and reasonable schedule for rates and classifications … "); and Objective 9 ([t]o allocate the total institutional costs … appropriately"). With respect to Objective 4, the Postal Service has repeatedly claimed it needs more pricing flexibility. But the cap system has afforded the Service much greater pricing flexibility than before 2007: Competitive product rates can be changed relatively easily and with short notice, market dominant rate changes no longer require onerous rate litigation and lengthy notice periods; compliance reports for the Annual Compliance Determination are not required until the end of the year; the Service can request and, where appropriate, has obtained transfers of products from the market dominant category to the competitive product category; and the Service can enter into market tests of experimental products and negotiated service agreements for all types of products. The Postal Service has taken advantage of this pricing flexibility, even proposing "under-water" rates for some Standard Mail products (while still in compliance with the class-wide cap).

[21] *Accord* Taub Testimony at 26.

[22] Under Subsection 3622(c)(14), the Commission may consider factors not listed in Section 3622(c).

- The Commission may change only the MD rate system under Section 3622.

Section 3622(d)(3) confines the ten-year review, and any changes resulting from it, to "the system for regulating rates and classes for market-dominant products established under this section."[23] The Commission does not have authority to change other parts of Congress's plan in the PAEA, whether that change is express or implied.[24]

- The Commission may not act in violation of any other provisions in chapter 36 of Title 39.

Section 3653(b)(1) requires the Commission to make an annual written determination "whether any rates or fees … [a]re not in compliance with applicable provisions of this chapter."[25] In establishing the Annual Compliance Determination (ACD), Congress ensured that every rate would comply with every provision in chapter 36, even after any changes resulting from the ten-year review.

- The Commission may not adopt changes that contravene other provisions in the PAEA (which might be found outside chapter 36).

A change that either violated express language or was irreconcilable with the intent of Congress in the PAEA would not be lawful. For example, a decision to modify the 45-days' notice provision in Section 3622(d)(1)(C) may not affect provisions in other chapters of the PAEA, but a decision to remove all or almost all price regulation of market dominant products would

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[23] *Cf*. Order No. 3673 at 2 (list of topics to be considered are restricted to those covered by Section 3622).

[24] For example, the Commission could not act so as to interfere with the market dominant/competitive distinction, the requirement of a minimum contribution from competitive products, the prohibition of cross-subsidization, or the required annual compliance determination.

[25] The Commission is to "take appropriate action [if a] written determination of noncompliance is made … as if a complaint averring such noncompliance had been duly filed and found under such section [3662] to be justified." 39 U.S.C. Section 3653(c).

eviscerate not only sections in chapter 36 (*e.g.*, Sections 3633 and 3642 on the distinction between market dominant and competitive products), but also sections in other chapters of the PAEA (*e.g.*, Section 2011 in chapter 2 and Section 404a in chapter 4). Similarly, the Commission could not adopt a change under Section 3622 that would conflict directly with Section 803 of the PAEA.

Application of these principles to Objective 5 will result in an interpretation consistent with the express language of the PAEA and the Congressional intent underlying it.

IV. OBJECTIVE 5 SHOULD NOT BE INTERPRETED TO REQUIRE THAT MARKET DOMINANT REVENUES CARRY THE ENTIRE BURDEN OF THE POSTAL SERVICE'S FINANCIAL STABILITY.

Order No. 3673's proposed analysis for Objective 5[26] focuses on the definition of the term "financial stability":

> *Preliminary definition.* In a system achieving Objective 5, the Postal Service is financially solvent while able to respond to changes in its environment (*e.g.*, volume erosion, legal or regulatory framework, demographic trends) and meet its statutory obligations (*e.g.*, pricing and universal service).
>
> *Potential measurement.* The key measurable concept within this objective is *"*financial stability*,"* which incorporates adequate revenues and retained earnings.
>
> "Financial stability" could be measured by reviewing short-term, medium-term, and long-term financial stability of the Postal Service….[27]

Aside from whether this definition resolves all ambiguity (and it does not),[28] the interpretation of Objective 5 must go beyond defining the term "financial stability." Objective 5 relates to the

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[26] 39 U.S.C. Section 3622(b)(5)(referred to herein as "Objective 5")

[27] Order No. 3673 at 7.

[28] Commentators have noted that the definition of "financial stability" is not settled. *See, e.g.,* http://www.worldbank.org/en/publication/gfdr/background/financial-stability ("[t]here are numerous definitions of financial stability"). When statutory language is subject to various interpretations, the agency may look to other parts of the statute and to Congressional intent for clarification.

“system for regulating rates and classes,” and states in full: “To assure adequate revenues, including retained earnings, to maintain financial stability.”[29] The entire phrase must be considered: What did Congress mean by “to assure adequate revenues … to maintain financial stability”?

One interpretation of Objective 5 might be that revenues from market dominant products *alone* must be adequate to ensure that the *overall* Postal Service is *always* financially stable. This would place the full responsibility for financial stability on MD revenues[30] and would be equivalent to removal of the cap. If MD rates alone are required to supply revenues adequate to maintain the Service’s overall financial stability, the cap system becomes no different from PRA-era breakeven ratesetting. The simplistic argument is that, if the Service needs more money,[31] and the cap prevents it from raising rates, then the cap system has not produced financial stability and should be replaced. The logical extension of this argument is that only the authority to raise market dominant rates any amount and at any time would be sufficient to ensure financial stability.

But Congress did not intend for market dominant products to be the safety net of the Postal Service or its guarantor of financial wellbeing. Instead of placing the entire burden on MD revenues, Congress envisioned several sources of revenue and a contribution from cost cutting, as well as a wide range of adjustments in operations, including closing post offices, realigning networks, and adjusting service levels. All of these were to contribute to financial

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[29] Sections 3622(a) and (b)(5).

[30] Rates for market dominant products, as currently set by the cap system under Section 3622, are referred to herein as “MD rates” and the revenues resulting from those rates are referred to as “MD revenues.”

[31] We do not address here whether the Postal Service’s assessment of its financial situation is accurate other than to note that other parties have challenged these claims. For purposes of these Comments, we assume the accuracy of the Postal Service’s claims.

stability. The PAEA's comprehensive plan, specific language, and history support this common sense interpretation:

First, as detailed above, the PAEA constituted comprehensive postal reform with many parts contributing to the Service's financial stability. Non-rate aspects included transferring billions into the RHBF, allowing greater pricing flexibility for both market dominant and competitive products, ending onerous and unpredictable rate case litigation, and providing incentives for cost savings from increased operational and administrative efficiencies. Revenues from market dominant rates (equal to the most recent breakeven rate base plus CPI and exigent increases), revenues from competitive product rates (set to achieve profits), and cost savings from increased efficiency and productivity were all to contribute to stability. One would have to willfully ignore the PAEA's entire reform plan to argue that MD revenues were to be the sole contributor to the Postal Service's financial stability.

Remarks by Congressional sponsors at the time of passage underline that the Act was intended to be a comprehensive package with all parts working toward the goal of strengthening the Postal Service's financial stability. Senator Frist described the wide range of reforms embodied in the PAEA and stated, "[t]his bill is comprehensive in the scope and depth of the reforms it institutes. But these changes are necessary and essential to helping the U.S. Postal Service continue its more than 225 years of reliable and efficient mail service."[32] Senator Collins said the purpose in passing the bill was to "ensure a strong financial future for the U.S.

[32] *Id.*

Postal Service;"[33] and Senator Carper stated that its provisions would contribute to a "stronger financial shape going forward."[34]

Second, Congress's use of the term "financial stability" in another section of the PAEA sheds light on its use here. Section 3641(e)(2)(b) provides that a market test of $50 million must be "likely to contribute to financial stability." At the least, this language demonstrates that Congress contemplated other contributors to financial stability besides MD revenues.

Third, careful parsing of the language in Objective 5 shows a distinction between the words "assure" and "maintain." The Merriam-Webster Dictionary[35] defines these terms as:

> *assure* – "to make certain the coming or attainment of"
>
> *maintain* – "to keep in an existing state … to sustain against opposition or danger."

"Assure" implies a stronger, more affirmative obligation than "maintain."[36] Congress could have worded Objective 5 to place the full burden of financial stability on MD revenues, using the language, "[MD revenues must be] adequate to *assure* financial stability." But it chose not to.

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[33] During remarks on the floor just before passage, Senator Collins described Congress's purpose in passing the bill thus:

> [F]or several years now, the Postal Service has clung to the edge of an abyss. Under the business model in which it has been forced to operate, the Postal Service has been at great financial risk. In fact, the Government Accountability Office aptly describes it as a potential death spiral in which escalating rates lead to lower volume, which in turn leads to even higher rates, which in turn causes the Postal Service to lose more business. With this landmark reform legislation, *we will put the Postal Service on a firm financial footing* …. *This compromise will help ensure a strong financial future for the U.S. Postal Service.* Congressional Record—Senate, December 8, 2006, at S11674-S11677.

[34] Senator Carper identified one aspect of the legislation that would contribute to the Service's "stronger financial shape":

> [A] lot of money is going to be used to pay down the unamortized cost of health care. Tens of billions of costs will be paid off, and that will put the Postal Service in stronger financial shape going forward. *Id.*

[35] *See* https://www.merriam-webster.com.

[36] *See* related discussion in Section V, *infra*.

Finally, even the Postal Service acknowledges that there are many contributors to financial stability. In its 2017 Integrated Financial Plan, it states, "The Postal Service continues to pursue *financial stability* through [1] product development and innovation, [2] pricing, [3] improving operational efficiencies, and [4] reducing those costs that are within our control. The FY2017 Integrated Financial Plan (IFP) demonstrates the Postal Service's commitment to a *financially stable* organization by balancing revenue growth initiatives, cost controls and investments in the future."[37]

V. MD REVENUES HAVE NOT BEEN THE CAUSE OF FINANCIAL INSTABILITY.

Since MD revenues were not to be the sole contributor to financial stability, thoughtful analysis leads us to the next question: If MD revenues are to contribute part, but not all, of the Service's overall needs for financial stability, what part of those needs are they to contribute? We next consider the minimum contribution[38] to financial stability that Congress could have intended for MD revenues:

Objective 5 could be read to ensure that *the cap system would not itself give rise to financial instability*.[39] This interpretation–whether the cap system itself poses a risk to stability–is consistent with how other regulators charged with maintaining financial stability have approached their mission. For example, the Financial Stability Oversight Council, established by the Dodd-Frank Act, sees its role as "to *identify risks* to the financial stability of the United States." The Council "remains focused on taking steps to appropriately *address threats* to

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[37] 2017 IFP at 3 (emphasis and numbering added).

[38] "Contribute" and "contribution" are used in these Comments in their everyday sense, not as the technical term for the difference between the revenue of a product and its attributable costs.

[39] Such an interpretation would be consistent with Congress's use of the word "maintain" in Objective 5, and its more limited connotation. *Supra* at 14.

financial stability," including "break[ing] up *firms that pose a 'grave threat'* to financial stability."[40] Under this interpretation, Objective 5 would not be achieved only if the cap system itself posed a grave threat to the Postal Service. This might occur if, for example, market dominant rates gave distorted economic signals, significantly accelerated a death spiral, or in some other way resulted in financial turmoil. But, as discussed in the next section, market dominant products are not causing instability and are in fact covering attributable costs and an overwhelming majority of institutional costs.[41] The Service's financial problems in fact arise from obligations outside the market dominant arena.[42] MD revenues under the cap system have thus not been the cause of financial instability.

VI. MD REVENUES HAVE CONTRIBUTED ADEQUATELY TO THE SERVICE'S FINANCIAL STABILITY AS CONTEMPLATED BY CONGRESS.

A. MD Revenues' Contribution to Financial Stability Was To Be the Recovery of the Costs Embodied in the Last Rate Base and CPI and Exigency Increases.

As demonstrated above, Objective 5 does not require MD revenues to be the guarantor of the entire financial stability of the Postal Service. At the other end of the spectrum, Objective 5 may require only that MD revenues not give rise to financial instability. A reasonable interpretation of Objective 5 may lie between these two endpoints.

In Section 3622, Congress set forth how rates were to generate sufficient MD revenues to maintain financial stability. Market dominant rates were to be made up of four components: (1) the rate base at the time of passage (as established under the breakeven approach of the

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40 Financial Stability Oversight Council 2016 Annual Report, at i, 4 (emphasis added) (may be found at https://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2016-Annual-Report.aspx); *see also* https://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx,

41 *Cf.* 39 U.S.C. Section 3633(a) (rates for competitive products must cover "costs attributable" and "an appropriate share of the institutional costs").

42 *Infra* at 18.

PRA); (2) further adjustments to the rate base expressly provided for in Section 3622(f) (some of these were made in R2006-1 and others could have been made in the year after the date of enactment); (3) annual rate increases based on CPI; and (4) a possible exigency surcharge under Section 3622(d)(1)(E). Rates set under this formula covered all Postal Service costs to breakeven (including a contingency amount)[43] plus additional CPI and exigent increases. Congress did not assign to market dominant rates the recovery of any costs other than those folded into the rate base, subsequent CPI increases, and a possible exigency surcharge. It carefully recognized that unforeseen developments might occur, and it made provision for an exigency surcharge for "extraordinary or exceptional circumstances." But Congress did not impose on market dominant mailers any special obligation to contribute to the RHBF (in addition to what may already have been included in the rate base).

B. MD Revenues' Contribution to Financial Stability Has Been Adequate under Objective 5.

Over the past ten years, market dominant mailers have paid all four components of these rates, and revenues from them have covered attributable costs and the vast majority of institutional costs. MD revenues have thus fulfilled their role, as set by Congress, to contribute to financial stability. In fact, on an "operational basis," market dominant revenues, together with other revenues and cost-savings, have been adequate to maintain the Service's financial stability.[44]

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[43] In Docket No. R2006-1, rates were set to break even, *i.e.*, revenues covered variable costs, fixed costs of all kinds, and a contingency amount to cover the possibility of a shortfall.

[44] *Cf*. Taub Testimony at 9.

The Service's statements are in agreement with this. The Service has effectively managed the revenues and expenses within its control,[45] but it is the front-loaded RHB payment schedule that is the main cause of its financial problems.

> Among the mandated fixed costs, the Postal Service operates with an unaffordable requirement to fund retiree health benefits, even though those benefits are not fully integrated with Medicare. In fact*, if it were not for this pre-funding requirement, the Postal Service would have posted net incomes over the past several years rather than net losses, despite the volume declines* …. The FY2017 IFP projects controllable income of $0.1 billion, versus actual controllable income of $0.6 billion in FY2016 .… FY2017 net loss is forecasted to be $4.2 billion [when mandated prefunding payments are taken into account].[46]

Thus, the Postal Service's financial difficulties have been caused by the statutorily-mandated, "unaffordable requirement to fund retiree health benefits," not by inadequate MD revenues due to the cap or excessive operational expenses. Congress did not place on MD mailers the burden of recovering RHB amounts in addition to what was already included in the rate base, and the outstanding RHB obligation should not be used to justify a finding that the cap system has failed Objective 5. We urge the Commission to conclude that the cap system has achieved Objective 5 (and the other objectives) and not to proceed to Phase II. If, however, the Commission decides to proceed to Phase II, the following section addresses the issue of the defaulted RHB payments.

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[45] "Controllable Income" is defined as total revenue less controllable expenses. Expenses that are not controllable are categories like RHB prefunding. *See* 2017 IFP at 3. In its 2015 Financial Report issued as part of Docket No. ACR2015 (March 29, 2016), at 1 the Commission referred to these expenses as NOEs (Non-operating Expenses).

[46] 2017 IFP at 2-3 (emphasis added).

VII. THE COMMISSION SHOULD NOT USE THE DEFAULTED RHB PAYMENTS TO JUSTIFY MODIFYING THE CAP SYSTEM OR RAISING MD RATES.

A. The Commission Cannot Unilaterally Adopt a New Rate System to Recover the Defaulted RHB Payments through MD Rate Increases.

If the Commission proceeds to Phase II, it should not adopt a new rate system that would assign recovery of the defaulted RHB payments to market dominant mailers under the guise of seeking to achieve Objective 5. To do so would ignore the plain language of Section 803 and would violate Congress's intent.

Section 803 unequivocally states that the Service "shall pay" the designated prefunding amounts without any exceptions or conditions. It is rare for federal statutes to include a specific payment schedule rather than a general methodology,[47] and its inclusion in the PAEA emphasizes how important the RHB payment schedule was to Congress. In authorizing the transfer of over $20 billion into the RHBF in the PAEA, Congress sought to deal with the healthcare prefunding problem highlighted by GAO. The RHB payment schedule was an integral part of the bill and a condition of its passage. Congress made no provision for defaults, and certainly did not authorize the Commission to cancel defaults or to break the cap to recover the RHB amounts from MD rates.

Congress's subsequent actions in 2009 and 2011 show that, even after lawmakers were informed that the Service would likely default on the RHB payments, they did not remove the statutory requirements, and they did not change the cap system to recover additional MD revenues for the RHBF. Instead, in 2009, Congress granted short-term relief, passing legislation to reduce that year's RHB payment to $1.4 billion.[48] In 2010, Congress rebuffed

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[47] Prefunding-related statutes and regulations may provide methodologies for calculating payments schedules, but we are unaware of any other federal statute that codifies a specific schedule for payments to OPM.

[48] Pub. L. 111-68, sec. 164, Oct. 1, 2009.

Postal Service requests for further relief, and the Service made the $5.5 billion RHB payment required by Section 803. In 2012, the Service informed key members of Congress it was dangerously short of cash, and Congress allowed one payment to be delayed to the following year.[49] PMG Donahoe testified before a House Subcommittee, "We have insufficient revenue to cover our costs and are rapidly approaching our statutory debt limit of $15 billion. *If the Postal Service were a private company, we would be engaged in Chapter 11 bankruptcy proceedings*."[50] In 2012 and every year thereafter, the Postal Service simply defaulted on the RHB payments without Congress's permission. There has been no legislation passed to resolve these defaults.

If Congressional action was required to grant the Postal Service a one year reprieve and to adjust the amount due in another year, then Congressional action is required to adjust or cancel the Service's defaults.[51] The postal bill now pending in Congress, H.R. 756,[52] explicitly acknowledges this. Section 102(c) provides:

> Cancellation Of Certain Unpaid Obligations Of The Postal Service.—Any obligation of the Postal Service under section 8909a(d)(3)(A) of title 5, United States Code, as in effect on the day before the date of enactment of this Act, that remains unpaid as of such date of enactment is canceled.

The bill recognizes that Section 803's payment schedule stands as a legal obligation until the "date of enactment of this Act," and only Congress, not the Commission or OPM, can resolve how the defaulted payments will be handled. The Commission cannot ignore the black letter

[49] Pub. L. 112-33, sec. 124, Sept. 30, 2011.

[50] Statement of Postmaster General/CEO Patrick R. Donahoe before the Subcommittee on Federal Workforce, U.S. Postal Service & Labor Policy, United States House of Representatives, March 27, 2012 at 1 (emphasis added).

[51] Nor does the Service's current financial situation justify an exception: In 2009, Congress did not cancel or make multi-year changes to the Section 803 schedule even though it was aware that "[i]f the Postal Service were a private company would [have been] engaged in … bankruptcy proceedings." *Id.*

[52] H.R. 756--115th Congress: Postal Service Reform Act of 2017. This bill is the successor to H.R. 5714 was introduced in the current Congress on January 31, 2017. Both bills contain the same Section 102(c). H.R. 756 was ordered reported by the Committee on March 16, 2017.

law of Section 803 and condone the Service's unlawful acts. An executive agency must enforce the law, not ignore or re-write it.

Subsection (d)(2)(B), which directs OPM to recompute the amounts due, does not change this. That subsection cannot be used to nullify the plain language of Subsections (d)(3)(A)(i) – (x), render superfluous the 2009 and 2011 laws, and violate the intent of Congress. Subsection (d)(2)(B) states in full, "[n]ot later than June 30, 2017, the Office [OPM] shall compute, and by June 30 of each succeeding year shall recompute, a schedule including a series of annual installments which provide for the liquidation of any liability or surplus by September 30, 2056, or within 15 years, whichever is later, of the net present value determined under subparagraph (A), including interest at the rate used in that computation." It delegates to OPM an administrative task—to recompute the annual amortization payment based on the balance in the RHBF each year (taking into account factors such as expenses, the actual growth of the fund assets, the current interest rates, and actuarial information). The subsection simply directs OPM to conduct a "true up" in 2017, a necessary first step to establishing a future payment schedule upon completion of the first ten-year schedule. Annual financial and actuarial information reporting such as this is a routine function of administrators of prefunded pension plans, and numerous regulations contain similar reporting requirements.[53] Congress never intended to allow this subsection to be used as a back door to cancel the legal obligations in Subsections (d)(3)(A)(i) – (x) for payments to be made from 2006 to 2016.

Moreover, raising MD rates to recover the defaulted RHB payments would relieve the Service of all consequences of its default and would vitiate Congress's intent to impose a measure of fiscal responsibility on the Postal Service to increase efficiency and cut costs. To

[53] *See, e.g.*, 29 C.F.R. Part 4010 (2017) (Annual Financial and Actuarial Information Reporting), at Section 4010.8; Department of Labor Rules on Annual Funding Notice for Defined Benefit Plans, Feb. 2, 2015, at http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28049&AgencyId=8&DocumentType=2.

allow it to escape any consequences for its default would contravene the intent of Congress in passing the PAEA. Changed circumstances since 2006 may in fact justify canceling the defaulted payments, but that is a decision for Congress. Congress may ultimately decide to forgive the USPS's violations of its mandates, but it is for Congress, not the Commission, to forgive.

In sum, the Commission cannot simply take OPM's new RHBF amortization schedule, which includes the defaulted amounts,[54] and order that MD rates be raised to recover the new annual payments. To do this would require the Commission to adopt a tortured reading of the PAEA, one that would (1) distort Objective 5 by placing the entire burden of financial stability (including the defaulted RHB payments) on MD revenues; (2) ignore the 2009 and 2011 laws showing that only Congress can modify the codified payment schedule; (3) effectively delete the unequivocal language of Subsections (d)(3)(A) (v) – (x); (4) stretch Subsection (d)(2)(B) to authorize the Commission to cancel the defaulted payments; and (5) use Objective 5's financial stability language again to justify a new rate system to reallocate the 2011-2016 RHB obligations to MD mailers. This is just too much to ask from Objective 5 and Subsection (d)(2)(B).

B. <u>A MD Rate Increase Resulting from this Docket Could Have Unintended Consequences and Could Frustrate Long-term Postal Reform Legislation.</u>

As long as Section 803 is on the books, Congress, instead of the Commission, must resolve defaults of payments mandated by that section. But there are also practical reasons why the Commission should refrain from unilaterally recovering these amounts through MD rate increases. Unintended consequences could result in harm to the Postal Service in the long run.

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54 We draw a distinction between (1) the new annual RHB payments (starting in 2017) based on the current balance in the RHBF, and (2) the new annual RHB payments based on what the balance would have been if the Service had made all Section 803 payments (with the exception of the Congressionally authorized deferral of $4 billion for 2009). At issue is the portion of the new annual RHB payments which arise from the unauthorized defaults (and their estimated interest).

First, a rate increase resulting from a Commission order and not part of a bill could affect the budget scoring of that bill. H.R. 5714 was reported out of committee and scored by CBO on November 11, 2006. It included, *inter alia*, a one-time rate increase of 2.15%, cancellation of the defaulted RHB payments and rolling them over into a new amortization schedule, use of postal-specific data for calculating retirement benefits, and requiring eligible postal retirees to use Medicare. The CBO report showed that the Medicare provision would increase federal on-budget costs by $7.8 billion over ten years, but would decrease the ten-year costs to the RHBF to $6.2 billion. The 2.15% rate increase accounted for an additional $8.4 billion of incoming off-budget revenues over ten years.[55] The CBO was able to reach a budgetary score for the unified budget that was generally considered acceptable. The Commission should consider whether this delicate balance will be upset if revenues from a rate increase are removed from scoring, having been previously ordered at the agency level and thus not considered part of the legislation.

Second, mailers who have already received a rate increase may perceive that they have less at stake and thus may be less enthusiastic in supporting legislation. The failure to pass a bill such as H.R. 756 would deny the Postal Service crucial changes such as the Medicare provision and the use of postal-specific data in calculating retirement benefits. These changes could significantly benefit long-term financial stability and could even result in decreasing the overall amount needed to fund the RHBF.

VIII. CONCLUSION

In 2006, Congress enacted a comprehensive plan for postal reform with many interdependent parts. In this ten-year review, the Commission can address only one aspect of that plan, the market dominant cap system. The cap system is a reasonable approach; it has

[55] CBO Report at 5, 11, 14, and 16.

worked well for ten years, and the burden to justify changing it has not been met. In particular, the cap system has achieved Objective 5 because MD revenues have contributed adequately to the Service's financial stability as Congress intended. The Postal Service has agreed that "were it not for [the RHB] pre-funding requirement, [it] would have posted net incomes over the past several years rather than net losses, despite the volume declines."[56]

Most parties agree that the RHB payments mandated in Section 803 are at the heart of the Service's financial problems. However, this docket is not the appropriate forum for resolving the defaulted RHB payments. Congress has sole authority to decide how to handle these payments, and the Commission should not intrude on Congress's authority by unilaterally canceling the defaults and relieving the Postal Service of all consequences of default. Increasing market dominant rates to fund RHB payments could also have serious unintended consequences for the mailing industry and the prospects of future legislation.

The Commission should refrain from making drastic changes in this docket and should continue to urge Congress to act. If Congress fails to pass legislation in the near future, Section 3622(d)(3) allows the Commission to re-examine the effectiveness of the cap system not only in 2017, but at any time "…as appropriate thereafter." In light of the legal restraints and practical considerations discussed in these Comments, we urge the Commission to find that the cap system has achieved Congress's objectives, or, alternatively, to defer major rate changes until after Congress has spoken.

Respectfully submitted,

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[56] 2017 IFP at 2-3